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TIC experts estimate $3-$6 billion in transactions to be completed this year

ICs Have Traction

As predicted, Tenants-In-Common (TIC) investments are really hitting stride. Experts had estimated that $3 to $6 billion in Tenancy-In-Common transactions would be completed this year. Based on some of the newsworthy sales and the apparent dearth of available product, I think the predictions are going to hold true. Notable deals include: the $27 million Shopping Center in Kauai, Hawaii; a $74 million office property in Houston; a $32 million and $75 million multifamily property in Irving, Texas and Fort Meyers, Florida, respectively; a $148 million Shopping Center in the City of Industrial California; a $24 million industrial property in Tempe, Arizona and a $22 million Hotel in Minneapolis, Minnesota.

As of this writing, our exclusive TIC Sponsor, The Geneva Organization, is closing or has closed on $70 Million in TIC transactions, with another $65 million in the pipeline (available for purchase in the third quarter). The ranks of national Sponsors has grown from approximately 10 to 40 in 2004, and the number is still growing. Even with the significant barriers to entry of establishing and sponsoring a TIC, Sponsors continue to come out of the woodwork.

TIC History

Tenants-In-Common as a property ownership structure has been popular for many years. It dates back to English Common Law and was first used to keep farms and estates physically intact, while allowing for multiple individual owners as heirs. In 1995, some practitioners started using TICs as replacement properties for 1031 Tax Deferred Exchanges (IRC 1031), allowing for multiple, individual owners to affect their exchanges into TICs, while retaining the capital gains tax deferral benefit of IRC 1031. Those investors were willing to accept the risk of IRS approval, since they were using attorneys' opinion letters as their sole security.

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What Changed?

In March 2002, the IRS ruled favorably in a Private Letter Ruling (PLR) (IRS Revenue Procedure 2000-22), publishing, for the first time, guidelines for IRS submission of further PLRs involving TIC structured deals for IRC 1031 Tax Deferred Exchanges. This ruling gave our industry a virtual "road map" for structuring Tenants-In-Common transactions to meet IRS scrutiny. Revenue Procedure 2000-22 opened the floodgates.

The main point of this ruling was to maintain the individual ownership of the property and to assure that the replacement property, if a TIC, would not resemble a partnership. The IRS does not want real property owners to reap the benefits of IRC 1031 while trading into a limited or general partnership. Revenue Procedure 2000-22 lays out fifteen guidelines to ensure this does not happen. For a copy of the IRS Revenue Procedure 2000-22 visit www.safeharborproperties.com.

1031 Pressure

There is a plethora of 1031 money flowing into the national real estate market. Recently, Deloitte & Touche estimated that between $50 billion and $60 billion in 1031 Tax Deferred Exchanges were completed in 2003, while another $25 billion failed!

This pressure seems to have no reason to abate. Our experience shows that almost every individual involved in a commercial real estate transaction, (at least) *considers* a 1031 exchange. From the sale of an office property in Manhattan to a shopping center in Chicago to farmland in Missouri; Sellers are considering a 1031. TICs are now another replacement property alternative.

Direct Investment

While 1031 exchanges continue to gain in popularity, direct investment in real estate as an alternative to other investments (stocks, bonds, commodities, etc.) is also heating up. This increased activity is fueled by positive media coverage of real estate investments, low interest rates, poor performance in other investment sectors, continued strong REIT results and the increasing age of the baby boomer generation. Many boomers are seeking lifestyle changes, but they want income, appreciation in value and control over their investments. TICs are a very good alternative for this sector.

The noted investment trend over the last twelve months is a reduction from 90-95% IRC 1031 driven transactions to 70-75%. The increased demand by non-1031 investors will undoubtedly continue, which will feed the overall TIC industry.

Sponsors

Today, most TICs are designed to allow up to 35 individual investors to provide the equity (and debt) necessary to purchase large, institutional-quality properties through a Sponsor. The Sponsor acts as the investment catalyst and often retains an asset management role after the closing.

Each individual investor obtains a deed of ownership (albeit pro-rata), as well as the depreciation, cash flow, mortgage interest deduction, principal reduction and property appreciation associated with the TIC.

Why Consider TICs?

• TICs have passive, direct ownership that allow for lifestyle changes while maintaining property level control.

• The ability to invest into multiple TICs, and mitigate risk through portfolio diversification.

• TICs offer the opportunity to invest in much larger, institutional-quality properties, which usually provide better tenants, professional management, less deferred maintenance, and more potential for appreciation.

• TICs can provide the tax benefits of direct ownership including the aforementioned IRC 1031 Tax Deferred Exchange.

• Many TICs have prearranged non-recourse financing, reducing investor headaches.

Some of the pitfalls of TICs are:

• Revenue Procedure 2000-22 is not code. Each TIC will have to survive audit and the associated risks.

• TIC Sponsors are like partners. Some are good and some are not. Do your homework!

• Exit strategies for individual TIC units may not be clear at the property level.

What is Next?

TICs are gaining in popularity and have become a significant form of syndicated property ownership. The TIC market will experience the growth realized by other syndications (REITs, limited partnerships and general partnerships) as demand for commercial investment property increases. There are many excellent TICs created by good, quality Sponsors, but there will be bad TICs as well. Professionals and investors will be faced (more often) with the prospect of selling, buying, advising or managing people or properties associated with TICs. It is imperative to be educated about TICs, since one can either embrace Tenants-In-Common investing or simply watch the TIC business boom around them.

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